



0000065541

RECEIVED
AZ CORP COMMISSION

BEFORE THE ARIZONA CORPORATION COMMISSION

JUN 20 1 43 PM '96

DOCUMENT CONTROL

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

DOCKETED

JUN 28 1996

DOCKETED BY

DOCKET NO. U-0000-94-165

IN RE RETAIL ELECTRIC COMPETITION)
INVESTIGATION)

COMMENTS OF PHELPS DODGE MORENCI, INC.

Phelps Dodge Morenci, Inc. (Phelps Dodge) submits the following in response to the February 22, 1996 request for comments on electric industry restructuring. Although the request sought comments on two sets of global issues, Phelps Dodge's comments address only certain of the points and factors that must be considered and addressed in any retail electric competition program solution. Phelps Dodge is not currently addressing many of the issues identified by the staff because those issues require specific analyses that are best formulated by economic or other experts.

Phelps Dodge also encourages the Commission to continue the open and participatory process it has used so far in this docket. This phase of the investigation should include additional opportunities to review and comment upon any proposed pilot program or any other documents drafted as a result of this round of comments.

. . .

. . .

- 1 **1. All public service corporations should open their**
2 **markets to competition as soon as practicably**
3 **possible.**

4 To have an effective competitive environment, all public service
5 corporations must open their markets to competition, regardless of
6 whether those entities are investor-owned or cooperatively-owned or
7 otherwise. Otherwise, many customers may be unable to participate in
8 the benefits of competition simply because they happen to be located
9 in the wrong place. Moreover, if there were a patch work of utility
10 service areas in which competitive programs existed amid other
11 service areas without competition, effective statewide competition
12 probably would be slow to develop. All utilities should be encour-
13 aged to participate to bring the acknowledged benefits of competition
14 to as many customers as possible.

15 In addition, non-public service corporations certainly must be
16 allowed and encouraged to participate in the competitive market.
17 This would increase the opportunities for all customers to benefit
18 from competition and decrease the detrimental patch work effect.
19 Unless non-public service corporations are permitted to participate,
20 Arizona will run the risk of establishing ologopolistic markets with
21 few choices for customers. Clearly, non-public service corporations
22 including power marketers, brokers, merchant wholesalers and the like
23 will promote development of choice for consumers.

- 24 **2. Restructuring should not interfere with existing or**
25 **future bilateral contracts between energy providers**
26 **and their customers.**

Any restructuring that occurs in the electric industry may
result in conflicts arising from power contracts between utilities

1 and their customers. However, the fact that a restructuring of
2 markets may emerge should not prevent bilateral arrangements from
3 continuing to be established for the sale and purchase of power and
4 energy. Similarly, any restructuring should not interfere with
5 existing approved contracts and those contracts should run the course
6 anticipated by the parties. For example, restructuring should not
7 provide a procedure to revisit the terms of such contracts, such as
8 providing exit fees or other surcharges claimed necessary for
9 recovery of stranded costs. See comment 3, below. To the extent
10 stranded costs ultimately are determinable and recoverable as part of
11 the transition to retail electric competition, allowing existing
12 power contracts to remain in force will not place an undue portion of
13 the stranded costs on other customers. First, should a customer
14 decide to break a power contract early, the utility could have a
15 legal action to recover all appropriate damages it can prove resulted
16 from that breach. Second, if a customer decided to leave a utility's
17 system upon normal expiration of a power contract, the utility should
18 have no basis for a claim of stranded costs because the parties would
19 merely be fulfilling the expectation that electric service would
20 terminate at the expiration of the contract. In all events, any
21 restructuring should be required to carefully balance the contract
22 rights of all parties.

23 Moreover, existing power contracts depend on a utility's ability
24 to meet its obligation under the contract. Forcing divestiture of
25 utilities may seriously impede (or even excuse) performance of a
26 power contract by the utility. Therefore, restructuring should focus

1 on the appropriate unbundling of power services, not divestiture.
2 Unbundling should provide a better opportunity for a utility to meet
3 its obligations under existing power contracts.

4 Finally, because of the expected benefits of competition, the
5 existence of a power contract should not necessarily prohibit a
6 customer from participating in competition. The Commission should
7 not create or impose any disincentives or prohibitions to a customer
8 participating in competition, regardless of whether that customer is
9 a party to a power contract.

10 3. The determination of who should bear, in whole or in
11 part, any stranded costs associated with the transi-
12 tion to competition should await the analysis on a
utility-by-utility basis of the existence of such
claimed stranded costs.

13 Stranded costs have been intensely debated as the electric power
14 industry moves toward competition. The debate has focused on many
15 issues, including the basic questions of whether stranded costs exist
16 and how those costs should be calculated. At this point, stranded
17 costs are conceptual estimates that depend primarily on forecasts
18 about what the future will bring in the electric power industry. At
19 a minimum, great uncertainty surrounds this issue.

20 Perhaps the most critical issue in restructuring is who should
21 bear the uncertainty of the stranded costs issue. To alleviate the
22 potential of unfairly imposing stranded costs on particular parties,
23 the imposition of stranded costs should await a more accurate
24 assessment of the actual magnitude of stranded costs in Arizona.

25 . . .

26 . . .

1 Moreover, the question of recovery of stranded costs should be
2 addressed only after determining whether a particular utility may
3 legitimately suffer from the existence of costs claimed as stranded.
4 The determination of claimed stranded costs must proceed on a
5 utility-by-utility basis. First, at a minimum, utilities must bear
6 the results of decisions that were not reasonable or prudent.
7 Second, any policy of total recovery of reasonable and prudent
8 stranded costs from customers could impede the move to competition
9 because--depending on the recovery mechanism--customers may actually
10 incur increased power costs by switching power providers. Thus, the
11 amount of stranded costs that should be imposed on customers must not
12 exceed a level that would prevent them from enjoying the benefits of
13 competition. And all players in the marketplace--utilities,
14 marketers, brokers, etc.--should contribute to the recovery of those
15 costs.

16 Additionally, the Commission and lawmakers should develop
17 policies to require utilities to mitigate the impact of any costs
18 claimed to be stranded. Obviously a policy of absolute recovery by
19 a utility of all of its stranded costs is wrong because it would
20 eliminate any incentive for the utility to mitigate those costs.
21 Moreover, before a utility can recover any stranded costs, it should
22 be required to prove that it has mitigated the impact of the
23 transition to competition to the fullest extent possible, beginning
24 as of the date this docket was opened.

25 . . .

26 . . .

1 4. Stranded costs, to the extent they are determinable
2 and recoverable, should be imposed only on customers
3 who have not paid for the investment incurred by the
 utility to serve that customer.

4 Stranded costs undoubtedly will vary from utility to utility.
5 Similarly, a customer's obligation to pay for stranded costs, if any,
6 will vary from customer to customer. Use of a simple formulaic
7 method for determining and assessing stranded costs could unfairly
8 punish certain customers while benefiting utilities. Before any
9 stranded costs are imposed, an evidentiary proceeding concerning the
10 existence, reasonableness, prudence and mitigation of those costs
11 must occur. This procedure will be a particularly fact intensive
12 inquiry. Utility customers must have an opportunity at such a
13 proceeding to present evidence concerning whether they should bear
14 any portion of stranded costs.

15 As a result of such evidentiary proceedings, stranded costs, to
16 the extent they are determinable and recoverable, should only be
17 imposed upon customers in those circumstances where the utility has
18 made an investment to serve the customer, but the customer has not
19 paid for that investment. Numerous situations exist where it would
20 not be fair or proper to impose stranded costs on a customer, even if
21 that customer is leaving a utility's system. For example, large
22 industrial customers often pay for a utility's investment in the
23 source of power for the customer (such as a power plant or wholesale
24 power requirements contract) through the terms of a power contract or
25 through the applicable rate structure. A power contract between a
26 large industrial customer and a utility usually contains a demand

1 charge or rate as well as an energy charge. A take-or-pay demand
2 charge in such a contract is designed to insure that the utility will
3 have an opportunity to recover the capital costs incurred to serve
4 that customer over the term of the agreement. Over the course of the
5 power contract, the customer basically pays for the plant needed to
6 meet the demand. Only an energy rate is based upon variable-cost
7 recovery. That rate is driven by the cost of fuel, purchased power
8 and other variable costs of providing the energy actual consumed by
9 the customer. Thus, over the course of a long-term power contract,
10 a large industrial customer may repay a utility's entire capital cost
11 (or more) of the facilities used by the utility to provide service to
12 that customer. Further, such customer will compensate the utility
13 for its variable energy costs plus a margin.¹ To require a customer
14 who over time has essentially paid for the facilities that provide
15 its power to also pay a portion of the utility's overall stranded
16 costs would be punitive and would result in a financial windfall for
17 the utility. An evidentiary proceeding will prevent utilities from
18 gaining such windfalls or customers from bearing an unfair portion of
19 such claimed stranded costs.

20

21 . . .

22 . . .

23 . . .

24

25 ¹ The margin allowed through rates approved by the Commission
26 for investor-owned utilities is a return or profit. The margin
approved for cooperatives is a ratio above a cooperative's debt and
interest coverage.

1 5. Using self-generation should not result in the imposi-
2 tion of stranded costs on a customer leaving a
 utility's system.

3 One of the options a power customer has always had even prior to
4 the advent of wholesale or retail competition is self-generation.
5 Because the recovery of the stranded costs is intended to ameliorate
6 the impact of the transition to competition on a utility's capital
7 investment, a customer leaving a utility's system for self-generation
8 should not be penalized by an exit fee or other cost surcharge
9 arising from the transition to competition. Power customers have
10 always had the opportunity--and utilities have always faced the
11 potential risk--of customer-installed generation. If a customer opts
12 for self-generation, the utility should not be entitled to a stranded
13 cost claim because that risk was always inherent in service to
14 customers--especially large customers.

15
16 DATED: June 28, 1996.

17 Respectfully submitted,

18 BROWN & BAIN, P.A.

19
20 By: 
21 _____
22 Lex J. Smith, Esq.
23 Michael W. Patten, Esq.
24 2901 North Central Avenue
25 Post Office Box 400
26 Phoenix, AZ 85001-0400

1 ORIGINAL and ELEVEN (11) COPIES of
2 the foregoing filed this 28th day
of June, 1996, with:

3 Docket Control Division
4 ARIZONA CORPORATION COMMISSION
5 1200 West Washington Street
Phoenix Arizona 85007

6 COPIES of the foregoing hand-delivered
7 this 28th day of June, 1996, to:

8 Paul Bullis, Esq.
9 Chief Counsel
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

10 Mr. Gary Yaquinto
11 Director, Utilities Division
ARIZONA CORPORATION COMMISSION
12 1200 West Washington Street
Phoenix, Arizona 85007

13 Mr. David Berry
14 Chief, Economics and Research
Utilities Division
15 ARIZONA CORPORATION COMMISSION
1200 West Washington Street
16 Phoenix, Arizona 85007

17
18 
19
20
21
22
23
24
25
26